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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JANUARY 2007

OVERVIEW

- In the third quarter of 2006 real gross domestic product (GDP) grew 1.7% following a 2.0% gain in the second quarter.
- Real final domestic demand growth slowed to 2.8% in the third quarter from 3.6% in the second quarter. Residential investment declined 8.2%. Growth in government spending on goods and services slowed, mainly reflecting a winding down of census-related expenditures. Also, business inventory accumulation weakened.
- Real exports increased after two consecutive quarterly declines while import growth slowed. As a result, international trade had only a marginally negative impact on growth. The current account surplus edged up $1.6 billion from $18.7 billion in the second quarter. At 1.4% of nominal GDP, this was the 29th consecutive quarterly surplus.
- Employment grew 0.4% in the third quarter, a much slower rate than the 3.1% pace in the second quarter. The unemployment rate inched up from 6.2% in October to 6.3% in November.

Real GDP increases 1.7%

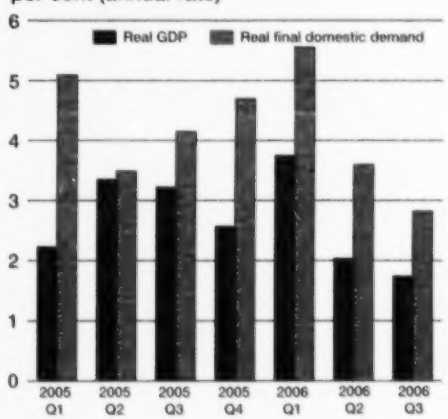
Real GDP rose 1.7% in the third quarter of 2006. Final domestic demand growth slowed, although it continued at a solid pace (Chart 1).

Consumer spending remains healthy

Real consumer expenditure grew 4.2% in the third quarter following an increase of 3.8% in the second and 4.8% in the first (Chart 2). Spending on durables, semi-durables, non-durables and services all rose. Notably, sales of motor vehicles rebounded after a drop in the previous quarter.

Personal income grew 5.3% in the third quarter. Labour income climbed 4.4% after a 1.1% increase in the second quarter, as stronger gains in wages and salaries per employee more than offset slower employment growth.

Chart 1
Growth in real GDP and real final domestic demand
per cent (annual rate)



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is end of day, December 12, 2006.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	2004	2005	2006:Q1	2006:Q2	2006:Q3		Most recent
Real gross domestic product	3.3	2.9	3.8	2.0	1.7		–
Final domestic demand	4.2	4.3	5.6	3.6	2.8		–
Government expenditure							–
Goods and services	3.0	2.7	3.3	4.9	0.7		–
Gross fixed capital	3.3	6.8	6.7	3.4	0.5		–
Consumer expenditure	3.3	3.9	4.8	3.8	4.2		–
Residential investment	7.8	3.2	14.2	-4.8	-8.2		–
Business fixed investment	9.1	9.4	8.1	5.4	7.0		–
Non-residential construction	7.4	7.9	8.4	3.0	4.7		–
Machinery and equipment	10.3	10.5	7.9	7.4	8.9		–
Business inventory investment ($ billion)	9.7	15.5	11.5	18.6	15.3		–
Exports	5.2	2.1	-3.8	-1.7	3.6		–
Imports	8.2	7.1	-2.0	8.6	4.1		–
Current account balance							
(nominal $ billion)	27.6	31.8	42.1	18.7	20.3		–
(percentage of GDP)	2.1	2.3	2.9	1.3	1.4		–
Nominal personal income	5.0	5.0	11.7	-1.2	5.3		–
Nominal personal disposable income	4.7	4.2	14.6	-1.9	5.7		–
Real personal disposable income	3.2	2.5	12.8	-3.8	5.6		–
Profits before taxes	18.3	10.6	-13.3	2.6	11.2		–
Costs and prices (%, y/y)							
GDP price deflator	3.0	3.2	3.7	2.9	1.4		–
Consumer Price Index (CPI)	1.9	2.2	2.4	2.6	1.7	0.9	Oct-2006
Core CPI[1]	1.6	1.6	1.7	1.8	2.1	2.3	Oct-2006
Unit labour costs	1.7	2.3	2.8	2.1	1.6		
Wage settlements (total)	1.8	2.3	2.2	2.7	2.6	2.5	Sep-2006
Labour market							
Unemployment rate (%)	7.2	6.8	6.4	6.2	6.4	6.3	Nov-2006
Employment growth	1.8	1.4	1.6	3.1	0.4	1.6	Nov-2006
Financial markets (average)							
Exchange rate (U.S. cents)	77.0	82.6	86.6	89.1	89.2	86.81	12-Dec-06
Prime interest rate (%)	4.0	4.4	5.3	5.9	6.0	6.00	12-Dec-06

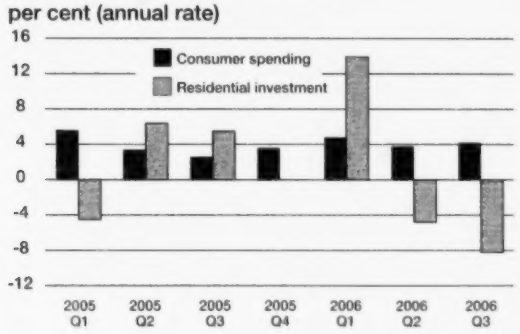
Note: Real values are in chained 1997 dollars.
[1] Core inflation excludes eight of the components of the CPI basket that display the greatest volatility, as well as the effect of changes in indirect taxes on the remaining components.
Sources: Statistics Canada, the Bank of Canada and Human Resources and Social Development Canada.

Real personal disposable income rose 5.6% and per capita real personal disposable income increased 4.3% to stand more than 22% above its trough in the second quarter of 1996. The personal savings rate was 1.5%, up from 1.2% in the second quarter.

Residential investment decreases

Residential investment fell 8.2% in the third quarter following a 4.8% decrease in the previous quarter (Chart 2). New construction activity weakened 12.5% as housing starts fell for a second consecutive quarter. House resales also declined, reducing agents' commissions and ownership transfer costs. Renovations increased 3.5%.

Chart 2
Growth in consumer spending and residential investment



Business investments in plant and equipment remain strong

Supported by healthy profitability, business spending on plant and equipment registered a 15th consecutive increase in the third quarter, up 7.0%. Non-residential construction grew 4.7% on the strength of a surge in engineering projects. However, spending on building construction, such as office towers and shopping malls, weakened for the second consecutive quarter.

Investment in machinery and equipment rose 8.9%, the 15th consecutive increase. Business capital spending on motor vehicles, computers, software and industrial equipment climbed while that on telecommunications equipment weakened.

Reduced business inventory buildup

Businesses added $15.3 billion to inventories in the third quarter, down from the $18.6-billion accumulation in the second quarter. Wholesale and retail inventories fell. Manufacturing inventories rose, as imports of motor vehicles outpaced domestic sales. Despite the smaller overall accumulation, the inventory-to-sales ratio increased to its highest level in over two years.

Exports climb after two declines

Real exports increased 3.6% in the third quarter following two consecutive declines (Chart 3). Exports of industrial goods and machinery and equipment jumped, reflecting solid U.S. business investment. However, exports of automotive products, cars, trucks and parts plunged, likely reflecting a drop in U.S. sales of North American-produced motor vehicles in the previous quarter. Exports of services fell 5.6%.

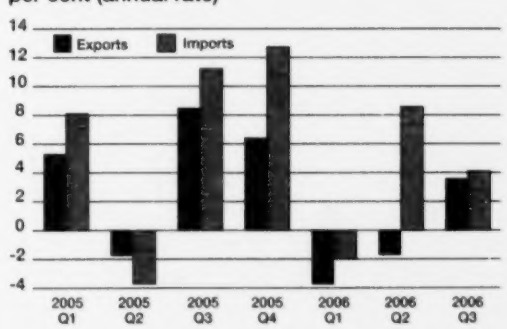
Imports increase more than exports

Real import growth slowed to 4.1% from 8.6% in the second quarter for a 12th increase since the end of 2002, when the Canadian dollar began to appreciate. Sharp gains in machinery and equipment and automotive products more than offset lower imports of industrial goods. Increased automotive imports reflected a double-digit gain in vehicle sales in Canada. Higher machinery and equipment imports were a response to greater business spending. Imports of services fell 5.4%.

Current account surplus edges higher

In the third quarter, a decline in the terms of trade reinforced the slight negative impact of real trade movements on the nominal trade surplus. Import prices rose more than export prices, as the price of imported energy products increased while that of exported energy decreased. The trade surplus fell $3.0 billion to $31.9 billion. However, the investment income deficit improved $4.4 billion, as profits Canadians earned on direct investments abroad rose. The current account surplus edged up by $1.6 billion to $20.3 billion or 1.4% of nominal GDP.

Chart 3
Growth in real exports and real imports



Healthy corporate profits continue

In the third quarter, corporate profits rose 11.2%, boosting their share of nominal GDP from 13.7% in the second quarter to 14.0% in the third, slightly below the historical high set at the end of 2005. The historical average is 10.2% (Chart 4). Rising metal prices boosted mining profits. High prices helped raise the profits of petroleum and coal manufacturers. The construction and banking industries also made solid gains.

Consumer price inflation remains subdued

The GDP deflator, a comprehensive measure of prices, rose 0.5% in the third quarter, up from a decline of 0.4% in the second, to stand 1.4% higher than a year earlier.

Year-over-year consumer price inflation fell to 0.9% in October from 2.8% in May, owing in part to the cut to the goods and services tax rate and a drop in energy prices. At 2.3% in October, core CPI inflation, which excludes the eight most volatile items and the effect of changes in indirect taxes, sat just above the 2% inflation target.

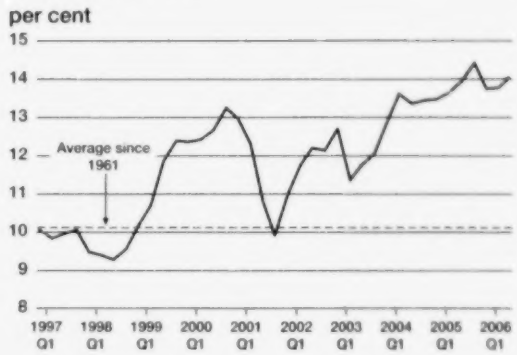
Low unemployment rate edges higher

Small net job losses in June, July and August restrained employment growth to 0.4% in the third quarter. However, solid job growth in October and November raised net job creation in Canada to a healthy 283,200 since the end of 2005. The participation rate stood at 67.2% in November, up from 67.1% in October.

After dropping to 6.1% in May and June, the lowest level in over 30 years, the unemployment rate has edged higher. In November, it sat at 6.3%, up from 6.2% in October, but down from 6.5% in August.

Hourly labour productivity for the total economy rebounded by 0.3% in the third quarter after a 0.3% decline in the second, which was the first decline in two years. Labour costs per unit of output rose in the third quarter to sit 1.6% higher than a year earlier.

Chart 4
Profits before taxes as a share of nominal GDP



Bank of Canada holds policy rate steady

On December 5, the Bank of Canada held its key policy rate—the target for the overnight rate—unchanged at 4.25% for the fourth consecutive announcement, after seven one-quarter-percentage-point increases over nine months through to May 2006. The Bank stated, "the current level of the target for the overnight rate is judged at this time to be consistent with achieving the inflation target over the medium term." On December 12, the U.S. Federal Reserve maintained a policy rate of 5.25% for the fourth consecutive Federal Open Market Committee decision. That followed 17 increases during a period of monetary tightening that the Federal Reserve had initiated in June 2004. U.S. rates at all maturities exceed those in Canada.

The Canadian dollar climbed to close at a 28-year-high of 91.05 U.S. cents on June 12, as commodity prices remained high. It has eased since and closed at 86.81 U.S. cents on December 12.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Department of Finance Distribution Centre at 613-995-2855. For other inquiries about this publication, contact Steven James at 613-992-4321.
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